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July 12, 2012

**VIA EMAIL [ASABEY@COXCASTLE.COM]**

Andrew Sabey  
Cox Castle Nicholson  
555 California Street, 10th Floor  
San Francisco, California 94101-1513

Re: Santa Clara LAFCO - Service Review and Audit

Dear Mr. Sabey:

We are in receipt of your letter dated June 22, 2012 regarding the draft El Camino Hospital District Audit and Service Review ("Report"). I have been asked to address the various inaccurate and false statements in your letter with the intent to clarify these issues and allow the El Camino Hospital District ("District") to focus on implementing the recommendations in the Report regarding improving the transparency and public accountability of the District.

District's Treatment Compared to Other Special Districts

You have stated that it is unclear why the District is being subject to unequal treatment compared to other special districts. As you have not had the benefit of participating in the numerous meetings Santa Clara LAFCO ("LAFCO") has had regarding the District, we feel that it is important for you and the District to have a full understanding of the process LAFCO has engaged to review the District.

As you might be aware, the District was the subject of a Grand Jury investigation that raised numerous questions and concerns regarding the District's operations as well as the operations of the El Camino Hospital Corporation ("Corporation") and the acquisition of the Los Gatos Hospital. In early 2011, working with the District, LAFCO staff began researching several issues concerning the District, specifically trying to resolve the issue of whether the District is providing services beyond its boundaries by funding the purchase of a hospital in Los Gatos. During the course of this research, other issues relating to transparency in the financial and operational relationship between the District and the Corporation, and questions regarding the purpose / functions of the District and its use of property tax revenues also came to light.

In June 2011, after reviewing the initial staff analysis of these issues, and after considerable discussion, LAFCO directed staff to take a closer look at the District as part of the upcoming service review and to include an independent audit of the financing of the Los Gatos

Hospital purchase. The Commission determined that given the complexity of the issues, only an audit could verify the accuracy of the information and that it was LAFCO's responsibility and in the public's interest to conduct the audit along with the service review. Furthermore, the Commission wanted the District's service review to be prioritized to address the identified issues as soon as possible.

In August 2011, LAFCO staff recommended and the Commission agreed that a separate, focused service review and audit be prepared for the District. This approach allowed the Commission to prioritize the review, adequately address the specific issues, and retain consultants with the required specialized expertise. In September, a Draft Request for Proposals ("RFP") was circulated for review and comment to cities and special districts, including the District. The District provided comments on the Draft RFP, which LAFCO incorporated into the final RFP. The Commission authorized the release of the final RFP in October. Representatives of the District were present at all of these meetings and offered to cooperate with LAFCO in the process.

Based upon LAFCO's concerns regarding District transparency, and the acquisition of the Los Gatos Hospital as detailed in staff reports and discussed at numerous public meetings in June, August, and October of 2011, there was a need for a more substantial service review and audit of the District, which has been prepared.

#### Dissolution Findings

LAFCO has made no decision to dissolve the District. The Report focuses on the District making changes to its operations and practices, not on dissolution. However, the District incorrectly focused on dissolution, rather than working with LAFCO to make the changes that have been recommended, and in the process, created unnecessary confusion and angst in the community.

The Revised Report, dated July 11, 2012, does not include dissolution findings nor is there a mandate for dissolution. The report does not include any mandates. However, the Report does include several recommendations to improve transparency and public accountability. In the future, should LAFCO decide to initiate dissolution of the District, it shall do so in conjunction with a sphere of influence amendment.

#### Los Gatos Hospital and the District's Dialysis Centers

The District continues to emphasize that they can purchase property outside of District boundaries, however, there has been little emphasis or discussion about how the District would do so for the "benefit of the district and the people served by the district" as required by Health and Safety Code section 32121(j). The District cannot purchase property outside of District boundaries unless there is such a benefit to the District.

### Consistency with OPR Guidelines and LAFCO Policies

Your letter erroneously focuses on how the Report does not comply with OPR Guidelines. However, OPR Guidelines are “advisory” serving as a “tool” to LAFCOs, unlike the Cortese Knox Hertzberg Local Government Reorganization Act (“Act”), which governs LAFCO. As noted on page 1 of the Guidelines, “Existing law requires OPR to prepare guidelines, not regulations. This document should therefore be considered advisory and not regulatory.”

The Act, along with LAFCO’s policies, gives LAFCO broad authority and discretion to review and consider how the District operates. In fact, LAFCO is the only public agency with the authority to review the District in this manner. The Act requires LAFCO to prepare a written statement of its determination with respect to various categories, including “Accountability for community service needs, including governmental structure and operational efficiencies.” (Gov. Code 56430(a)(6).) In addition, LAFCO can consider “any other matter related to effective or efficient service delivery, as required by commission policy.” (Gov. Code 56430(a)(7).)

LAFCO also adopted a Service Review Policy (“Policy”) that provides on page 6 that the service review shall evaluate “governmental structure alternatives for organizational and operational efficiencies in order to accommodate orderly growth, prevent urban sprawl, ensure efficient delivery of services and improve accountability or governing practices.” In addition, LAFCO’s policies provide that the “Commission may adopt other determinations on a case by case basis based on unique local conditions, or changing circumstances such as changes to enabling legislation, regulatory requirements, or other unforeseen factors.” Furthermore, as noted above, the Report is more than a service review, and is also meant to be an audit of the District in light of the significant concerns presented by the Grand Jury, members of the public, and LAFCO.

You incorrectly state that LAFCO is only allowed to review the District’s SOI or reorganization to the extent such review is related to “efficient and affordable service delivery.” That is not what the Act provides, and as fully cited, “In conducting a service review, the commission *shall comprehensively review* all of the agencies that provide the identified service or services within the designated geographic area. The commission may assess various alternatives for improving efficiency and affordability of infrastructure and service delivery within and contiguous to the sphere of influence, including, but not limited to, the consolidation of governmental agencies.” (Gov. Code 56430(b) emphasis added.) Furthermore, “one of the objectives of the commission is to make studies and to obtain and furnish information which will contribute to the logical and reasonable development of local agencies in each county and to shape the development of local agencies so as to advantageously provide for the present and future needs of each county and its communities.” (Gov. Code 56301.)

### Management of the District

LAFCO is fulfilling its responsibilities under the Act. LAFCO is not managing the District, but making recommendations so that the District can improve its governmental structure and operational efficiencies, which LAFCO is expressly required to review and make determinations pursuant to the Act. It is disappointing that the District would not see this as an

opportunity to improve itself and implement good governance for the benefit of the public for which it serves, and instead chooses to spend significant time and resources to challenge LAFCO's express ability to review the District.

Service Review of District/Corporation

You have indicated that the Report focuses on the Corporation rather than the District. As the District is fully aware, the District and the Corporation are intertwined in numerous ways. This is demonstrated at a minimum by the makeup of the Board, staff, and financials. On numerous occasions representatives of the District, including your firm, have interchangeably used District and Corporation when referring to the District. Therefore, in order to complete a thorough and detailed audit, it was necessary to also include information regarding the Corporation that was relevant to LAFCO's review of the District.

LAFCO's work with the District

You have indicated that the Report was not cooperatively developed. We find this particularly surprising considering the numerous meetings held between LAFCO and the District, which also included members of your firm. Mr. Caligari of your office indicated in his letter to us, dated June 9, 2011 that the "District has been working with LAFCO staff in an open, collaborative and cooperative manner. District representatives have already attended several meetings with LAFCO staff regarding this manner." In addition, several LAFCO Commissioners have met individually with District representatives during this process.

LAFCO has made every effort to work with the District in producing this Report and has held several meetings with the District to ensure the accuracy of the Report. We also complied with a request made by your firm for advance copies of the draft report as a courtesy. Therefore, we were disappointed that the District's reaction to the Report was an unwarranted letter threatening to sue LAFCO rather than to consider and implement the reasonable recommendations for improving the District's governance and public accountability as permitted under the Act.

Very truly yours,

*Malathy Subramanian/ Jan.*

Malathy Subramanian  
for Best Best & Krieger LLP  
General Counsel  
LAFCO of Santa Clara County

cc: LAFCO Commissioners and Staff